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Nos. 79 and 80

In the Supreme Court of the United States

OCTOBER TERM, 1952

MARTHA L. ALISON

v.

THE UNITED STATES OF AMERICA

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v.

STEVENSON-CHISLETT, INC.

ON CERTIFICATES FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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REPLY BRIEF FOR THE UNITED STATES

There are certain matters in the taxpayer's brief in *United States* v. *Stevenson-Chislett, Inc.* (No. 80), which ought not to remain unchallenged, and the following reply brief is being filed in answer.

1. The taxpayer recognizes that Code Section 23 (e) (3) and (f), in permitting a deduction for embezzlement losses "sustained during the

taxable year," has long been interpreted to mean losses from embezzlements occurring during the taxable year. (Br. 8.) It asserts, however, that if a taxpayer is unable to determine the year or years of the embezzlement, there is (Br. 8) "a well-established exception," evidenced by (Br. 13) "numerous recent Tax Court decisions" within the past ten years which have followed *Boston Consol. Gas Co.* v. *Commissioner,* 128 F. 2d 473 (C. A. 1st), and which should be considered as creating an implied exception to the statute because (Br. 16) "Congress is satisfied with" the results of these cases, so that the statutory word "sustained," in this situation, must mean the year of the (Br. 19) "discovery" of the embezzlement. Upon analysis, it will appear that there is no firm basis for believing that Congress has, by implication, incorporated such an exception into the statute.

The "numerous cases" cited by the taxpayer do not, for the most part, represent the application of any such exception. Thus, *Felton* v. *Commissioner,* 5 T. C. 256 (Br. 11), does not at all stand for the proposition that an embezzlement loss can be deducted in the year of the discovery even though the embezzlement did not take place in that year. In that case, the taxpayer was considered by the Tax Court as having (p. 256) "deposited" money with the wrongdoer for investment. Since the taxpayer in *Felton* had agreed that the recipient of the deposit could commingle

the money with that of others, and could purchase securities representing the aggregate of the interests of several principals, the scheme of the wrongdoer was described by the Tax Court (p. 262) as "resembling that of an investment trust * * * *." Because of the maner in which the funds of the depositors or investors were being manipulated, the Tax Court recognized that the case was not the simple situation where a person's funds were being embezzled. It said (p. 262):

> We think much weight should be given in this case to the fact that petitioner advanced his money under a contract which permitted commingling of funds, and that during 1940 [the taxable year] the contract was still in effect as part of a network of similar contracts.

The Tax Court stated (pp. 262, 263) that "Under the unusual facts," it could not find "definitely that petitioner's [taxpayer's] money was embezzled, stolen, or lost prior to October 1940", and it "found as a fact that the loss was sustained in 1940," the year for which the deduction was being claimed. That factual conclusion could not be described as clearly erroneous. *Gilpin* v. *Commissioner,* decided April 8, 1947 (1947 P-H T. C. Memorandum Decisions, par. 47085), involved another victim of the same scheme considered in the *Felton* case. It is significant that the Tax Court concluded that there was a loss from an "investment", not from an embezzlement.

These cases, accordingly, turning on a resolution of the factual question of the year in which the investment loss occurred, certainly do not stand for the proposition that an embezzlement loss can be deducted in the discovery year when the embezzlement does not take place in that year. Indeed, the fact that neither case cited the decision in *Boston Consol. Gas Co., supra*, is a sufficient indication that the taxpayer is wrong in regarding the *Felton* and *Gilpin* decisions as examples of a supposed exception to the statute. Accordingly, the Commissioner's acquiescence in the *Felton* case (1945 Cum. Bull. 3) does not demonstrate an administrative acceptance of the rule of the *Boston Consol. Gas Co.* case, and the taxpayer is simply wrong in describing the acquiescence as representing instructions by the Commissioner to (Br. 8) "his subordinates in the Bureau" to accept the peculiar construction of the statute for which the taxpayer is contending.

It is questionable whether *Glenn* v. *Louisville Trust Co.*, 124 F. 2d 418 (C. A. 6th) (Br. 10), was correctly decided. However, that case, like the *Felton* and *Gilpin* decisions, did not involve any problem of embezzlement and it did not touch on the meaning of the statute here in question. The taxpayer recognizes (Br. 10–11) that *Miglietta* v. *Commissioner*, decided January 28, 1943 (1943 P–H T. C. Memorandum Decisions, par. 43045), is a decision where the embezzlement loss

was deductible, not in the year of discovery, but in the year when the embezzlement took place.

The "numerous recent Tax Court decisions" relied on by the taxpayer, consequently, are represented by only one case, i. e., *Gwinn Bros. & Co. v. Commissioner*, 7 T. C. 320 (which followed *Boston Consol. Gas Co. v. Commissioner*, 128 F. 2d 473 (C. A. 1st)). It is important to observe that in the *Gwinn* case the taxpayer had relied on the embezzler's express promise to repay—a promise which was later discovered to be worthless and which the taxpayer claimed entitled it to a bad debt deduction. Although the Tax Court did not rest its conclusion on the bad debt aspect of the case, the fact that the Commissioner acquiesced only in the result of the decision (1946-2 Cum. Bull. 2) demonstrates that there has been no administrative acceptance of the *Boston Consol. Gas Co.* rule.

In our opening brief it was pointed out that (p. 37): "We have been unable to discover any published ruling, interpretation, or instruction in which the Commissioner has construed the Regulations to possess such a meaning." The taxpayer, it can now be added, points to nothing which would demonstrate an administrative construction which recognizes the exception which it seeks to create. On the contrary, as is evident not only from this case and the *Alison* case (No. 79), but from all the reported decisions, the Government has consistently adhered to the posi-

tion that the loss cannot be deducted in a year in which there was no embezzlement. The opposite result of the *Boston Consol. Gas Co.* case and the opposite rationale of the *Gwinn Bros.* case do not, in the slightest degree, indicate a Congressional acceptance of those cases. As this Court said in *Jones* v. *Liberty Glass Co.*, 332 U. S. 524, 534: "We do not expect Congress to make an affirmative move every time a lower court indulges in an erroneous interpretation." Accord: *Commissioner* v. *Wheeler*, 324 U. S. 542, 545–546.[1]

The ultimate fact remains, as was pointed out in our opening brief (pp. 13–17), that the word "sustained" has, from the very beginning, been consistently construed to mean the year of the embezzlement and no other year. Since there has been no accepted practice which recognizes any defined exception to this long, continued construction, there is no room to argue that Congress has by its silence impliedly accepted any supposed exception.

2. The taxpayer (Br. 19–25) next argues that, in any event, the statutory word "sustained" is,

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[1] Even within the limits of its argument, taxpayer would find it hard to explain why Congress, by its silence, would have accepted as a proper construction not only the result in *Boston Consol. Gas* but also that of *First Nat. Bank of Sharon, Pa.* v. *Heiner*, 66 F. 2d 925 (C. A. 3d), for those decisions, while dealing with different aspects of the problem, are utterly out of harmony with one another.

by itself, flexible enough to permit a construction so that an embezzlement loss, in the circumstances of this case, is "sustained" when it is discovered, even though in other instances where the year of embezzlement and the year of discovery do not coincide it is "sustained" when the embezzlement takes place.

The taxpayer is unable to cite any persuasive authority which would demonstrate that Congress ever intended such a shifting meaning or that this loose definition is supported by any accepted administrative practice. The fact that the 1921 Act (the history of which is fully discussed in our opening brief, pp. 22–28) expressly added language to provide for the exceptional allowance of loss deductions in other years to clearly reflect income (though not necessarily covering the situation here) demonstrates that the existing word "sustained" was not so elastic in its meaning, for otherwise no exception would have been needed. When that exception was removed from the loss provisions by the 1924 Act, it seems plain that the word "sustained" in connection with embezzlement losses continued to mean what it had before, namely, the year in which the embezzlement occurs.

The taxpayer cites (Br. 22–23) *Lucas* v. *American Code Co.*, 280 U. S. 445; *Burnet* v. *Huff*, 288 U. S. 156; and *Boehm* v. *Commissioner*, 326 U. S. 287, as requiring a "practical" test for determin-

ing when a loss is sustained. Aside from the fact that those cases dealt with the question of when other kinds of losses should be regarded as sustained—a matter which, by administrative and judicial interpretation, has already become well settled for embezzlements—it should also be pointed out that the accepted interpretation which considers the loss as sustained when the embezzlement takes place is a practical one. It places the loss at an identifiable time so that neither the taxpayer nor the Government may attempt to shift the year of the deduction to suit their own tax advantage. That practical result would be lost if there were some vague exceptions which might permit the deduction to be claimed in more than one possible year.

The taxpayer's real complaint is not that the rule is impractical, but rather that a practical rule may sometimes result in hardship. The *Boehm* case (p. 295), however, demonstrates that the alleviation of any supposed inequity or hardship is to be accomplished by Congressional action and not by a judicial departure from a well-settled statutory meaning.[2]

[2] Throughout its brief, the taxpayer constantly assumes that it would be impossible for it to determine the precise years of the embezzlement, and that the application of the statutory rule would deprive it of the deduction altogether. In our opening brief (pp. 51–52) we point out why that is not necessarily so in the light of the actual findings of this case.

3. The taxpayer's next contention (Br. 25–30) seems to be that *Commissioner* v. *Wilcox*, 323 U. S. 404, overturned the previous, long accepted rule that an embezzlement loss is "sustained" when the embezzlement occurs. Because the *Wilcox* decision spoke of a debtor-creditor relationship arising out of the act of embezzlement, the taxpayer argues that (Br. 28)—

> the victim of an embezzlement should not be regarded as sustaining a loss at the time his funds are surreptitiously taken, but only when the fact of the loss becomes fixed and definite and the amount becomes reasonably determinable

and it concludes that an embezzlement loss is deductible (Br. 29–30) "in the year when it is determined how much of the embezzled funds are recoverable."

If it were valid, that reasoning, of course, would be applicable to *every* embezzlement situation, and could not be used to explain why the result in this case should be different from that in any other case. If the loss is considered as sustained only after the victim is aware of what has been lost, that would be universally true, even in the ordinary case where the loss is discovered the year after the embezzlement occurs. In such a case, if taxpayer is right, the loss could not be taken in the year of embezzlement because in that year it was not—and could not—be determined whether

the embezzler's obligation to repay the embezzled funds was in fact worthless. But, if there is anything in this field which is clear beyond question, it is that in such a case the loss is taken in the year of embezzlement. The *Wilcox* case, with the totally different problem there involved, was not intended to disturb the long, continued administrative and judicial construction which, from the very outset, has been put on Section 23 (e) (3) and (f) and its predecessors, namely, that the year in which an embezzlement loss is "sustained" does not depend on when it is ascertained that the claim against the embezzler is a worthless bad debt. Indeed, in *Rutkin* v. *United States*, 343 U. S. 130, 138, the *Wilcox* decision was said to be limited "to its facts."

This is not to suggest, if this were a matter of first impression, that the word "sustained" could not, as a matter of language, have been construed to have such a meaning, or that it would have been wrong for the Commissioner to have so interpreted the statute. We do, however, deem it clear that when the opposite construction has been followed for almost more than 35 years, the statute cannot suddenly have changed its meaning because of a decision which not only dealt with a different question (gain to the embezzler) but which expressly noted (p. 409) that there was no necessary relationship between the issue there and the deductions granted by Congress to the victim. If the settled meaning of the

statute is now to be changed, that should be done by Congress.[3]

4. Finally, the taxpayer urges (Br. 30-36) that, regardless of when the embezzlement loss was "sustained" within the meaning of Section 23, it should be permitted to deduct the losses of prior years in the taxable year because Code Section 43 requires such a result in order clearly to reflect the taxpayer's income.

We need not reply to the specific matters relied on by the taxpayer, for they are covered in our opening brief (pp. 18–39) where we have demonstrated why Section 43 is not applicable to embezzlement losses.

We do note, however, that nowhere in its discussion does the taxpayer explain how its income for 1945 (a year in which there admittedly was no embezzlement of its funds, and in which nothing else occurred which would have a bearing on its taxable gains of that period) is being reflected more clearly by means of a deduction on account of losses sustained in prior year. Nor

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[3] The taxpayer also argues (Br. 29–30) that its construction of the statute is supported by the language of Section 23 which limits the loss deduction to the extent "not compensated for by insurance or otherwise," it being contended that this demonstrates why the embezzlement loss is not sustained until the year when the victim ascertains the loss and the extent to which reimbursement is obtainable.

The short answer to that is that the same language has always been in the statute during the long course of time that the opposite construction has been accepted.

does the taxpayer attempt to clarify how the deduction of several years' losses in a single taxable year can be harmonized with Section 43 whose very purpose is to the contrary. The result which the taxpayer seeks will distort its 1945 income, rather than reflect it more clearly. This would contradict and frustrate the express purpose of Section 43.

5. The ultimate effect of the taxpayer's position is that one or more of the statutory provisions should be stretched in some manner or other to grant it relief from a harsh result in this particular situation. The taxpayer (Br. 15–16) does not contend that the statute should be so construed as to embrace every situation where a hardship is being claimed, for it contends that the exception can be read into the statute which will take care of its case, though not necessarily the situation where, as in the *Alison* case (No. 79), the discovery comes too late to permit the deduction to be claimed for the embezzlement year.

We submit, however, that if different exceptions are to be created for different situations, that is a matter properly addressed to the attention of the legislature. As we have pointed out in our opening brief (pp. 39–51) Congress is familiar with problems of this sort and it knows how to deal with them when it so intends. We also there noted why a legislative change, if there ever should be one, would not necessarily coincide

with the solution which these taxpayers seek by judicial decision.

Aside from the fact that a taxpayer who is dissatisfied with the operation of a statute should more properly submit the claimed grievance to the legislative branch of the Government, it seems appropriate to observe that there is no identifiable standard by which the judiciary can fashion an exception tailored for the present cases. Thus, with respect to the type of problem presented by this case, if an exception is created, the question must arise whether the deduction can be had in the discovery year only if it is *impossible* to ascertain the exact years of the embezzlement, or whether the exception will apply as well when it is (as seems to be true here) merely too expensive to ascertain that fact. If it is to be the latter, is the expense limit to be determined in relation to the size of the loss deduction? What should the result be if the fact of the embezzlement is discovered in one year and the impracticability of ascertaining the embezzlement years is not learned until later? Finally, both this case and the *Allison* case present the problem of how, if the discovery year is to be the deduction year, there can be avoided the necessary distortion of income that must ensue if the losses of more than one year are to be lumped as a single deduction in a single tax year—a distortion of income against which the statute expressly guards in Section 43.

These are some of the problems that are bound to attend the creation of the kind of exception which these taxpayers are urging. If Congress should ever carve out such an exception, it would undoubtedly do it in a manner designed to answer these attendant issues in accordance with some legislative principle—a solution which, in the absence of such a standard, cannot be supplied by judicial decision.

CONCLUSION.

The decision of the District Court in *Alison* v. *United States* (No. 79) should be affirmed. The decision of the District Court in *United States* v. *Stevenson-Chislett, Inc.* (No. 80) should be reversed.

Respectfully submitted.

ROBERT L. STERN,
Acting Solicitor General.
CHARLES S. LYON,
Assistant Attorney General.
ELLIS N. SLACK,
LEE A. JACKSON,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

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